Esma laments misuse of SFDR as marketing tool

By Amie Keeley 31 March 2022

The EU's markets watchdog has publicly acknowledged that the Sustainable Finance Disclosure Regulation is not being used in the way it was intended by fund managers.

In a speech given earlier this week, the executive director of the European Markets and Securities Authority, Natasha Cazenave, says SFDR is being used to market funds to investors instead of merely providing transparency on the environmental credentials of financial products.

SFDR came into force last March and is designed to standardise sustainability disclosure to help investors understand and compare the environmental characteristics of funds.

However, fund selectors and sales teams are using the classifications as a product filter, providing investors with a signpost to where they can invest sustainably, as previously reported.

Addressing the ICI Investment Management Conference on Tuesday, Ms Cazenave says: "One important development we need to recognise is that although SFDR was primarily a transparency regulation, both fund managers and investors are increasingly treating the disclosures categories as product classification.

"More and more investment funds market themselves as either [article eight or nine] SFDR – meaning products promoting environmental or social characteristics and products with sustainable investment as their objective."

Out of a sample of 27,000 EU funds representing €10 trillion in assets under management, 30 per cent of funds include either an article eight or nine statement under SFDR in their pre-contractual documentation, according to Esma.

An article nine fund has sustainable investment or a reduction in carbon emissions as its objective, while an article eight fund "promotes, among other characteristics, environmental or social characteristics".

Article six funds do not integrate sustainability into their investment process to the extent required by articles eight or nine, although all funds that are subject to SFDR must consider sustainability risks.

Ms Cazenave highlighted issues around article eight products, which she says have been "called out for less ambitious environmental or social characteristics".

"In light of this we must think ahead and consider appropriate criteria to ensure that investors who are looking for sustainability features in their financial products are offered products matching their preferences," she adds.

Concluding her speech, Ms Cazenave says: "We firmly believe that there needs to be extreme vigilance on the risk of greenwashing to preserve investor trust in capital markets and that the strong regulatory and supervisory framework we are building in the EU should help support the sound growth of the ESG market."

Adrian Whelan, global head of regulatory intelligence at Brown Brothers Harriman, says initial SFDR requirements only demand high-level qualitative disclosures, which are "hard to prove or disprove presently".

"Due to this dynamic, many asset managers have felt commercial pressure from both their investors and distributors to elect into higher SFDR designations since funds with these product labels are deemed easier to sell," he says.

The European Fund and Asset Management Association says the fact that SFDR article eight and nine are seen as "de facto" fund labels by some is a "cause for concern, as it may lead to incorrect expectations by the investor".

There has been widespread confusion over what constitutes an article eight fund, with experts warning the "broad" definition has led to wildly different interpretations among firms that are having to walk a fine line between commercial gain and reputational harm.

Simone Gallo, managing director at Mainstreet Partners, a sustainable investment advisory firm, says analysis of 4,200 funds showed that around a fifth of those labelled as article eight achieved a low ESG rating.

"This is an obvious sign for us that there is a very large number of article eight funds that could be at risk of greenwashing," he says.

Last year Esma put forward proposals for two new product categories under article eight and nine funds to take account of the classifications from the EU taxonomy for sustainable finance.

The article nine threshold will be broken up to create a subset of article nine funds that explicitly have an environmental objective.

The article eight threshold will be split in two to create a new category of article eight funds that "make sustainable investments with an environmental objective".

Agnès Lossi, partner at Indefi, says the taxonomy will play an "essential role in separating the wheat from the chaff".

"They are the indicators that we expect to be widely used to match client preferences, not the SFDR classification or a scoring methodology."

She adds: "Fundamentally, it is important for asset managers to remember that SFDR classification should not be the entry point of their product strategy, it should be the result of a thoughtful sustainable investment vision and integration process."